

# **U.S. ENVIRONMENTAL PROTECTION AGENCY ENVIRONMENTAL FINANCIAL ADVISORY BOARD**

July 18, 2003

Honorable Marianne L. Horinko  
Acting Administrator  
U.S. Environmental Protection Agency  
Washington, D.C. 20460

Dear Acting Administrator Horinko:

In June 1999, the Governmental Accounting Standards Board (GASB) established new financial reporting standards that have fundamentally changed the way State and local governments report their financial results. Among other provisions, GASB "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments," requires that major infrastructure assets acquired or having major additions or improvements in fiscal years beginning after June 15, 1980, be capitalized in financial statements. In addition, the cost of using the assets must be reflected.

EPA has the opportunity to promote aspects of GASB 34 requirements that would lead to improved financial reporting by environmental utilities to regulatory agencies. In addition, compliance with GASB 34 will encourage utilities to better maintain environmental infrastructure; provide increased assurance to citizens that environmental needs are more effectively being addressed; provide for better benchmarking of environmental infrastructure operating and capital costs among agencies; and provide improved asset and cost information for EPA and regulatory agencies to award financial assistance to requesting agencies.

To understand the implications of GASB 34 and EPA's role related to GASB 34, the Environmental Financial Advisory Board (EFAB) sponsored a workshop in Washington, DC early last year. The workshop was facilitated by EFAB member Mr. George Raftelis and included opening remarks Mr. Michael Deane, Chair of the Cost-Effective Environmental Management Workgroup of EFAB and myself. Panelists included Mr. Tom Allen, Chairman of the Government Accounting Standards Board, and representatives of utility management, EPA and state regulatory agencies, financial and lending institutions, bond rating agencies, Environmental Finance Centers, the Government Finance Officers Association, and public accounting representatives. Results from the workshop were summarized and documented (attached), and have provided a basis for recommendations in this Summary.

The major provision of GASB 34 that provides EPA with an opportunity to promote the benefits of regulated agencies deals with the method of accounting for and reporting infrastructure. Specifically, GASB 34 allows governments to account for infrastructure using one of the following methods:

- Depreciation Approach
- Modified Approach

The modified approach is attractive in that it allows governments, in lieu of depreciating their assets, to adopt a systematic approach to managing those assets that, at a minimum, meets the following four requirements:

- Having a current inventory of eligible assets
- Documenting the condition of those assets via a reproducible assessment procedure
- Demonstrating that assets are being preserved at level predetermined by the government
- Estimating the actual cost to maintain and preserve the assets

The modified approach requires governments to develop asset management systems, and assure that proper investment is made to maintain environmental infrastructure in an appropriate condition. Regulatory agencies benefit through improved reporting of infrastructure information and assurance that federal and state dollars used for infrastructure are being optimized by agencies receiving financial assistance. Utility customers benefit by being assured that user fees are effectively maintaining their systems.

Associations in the environmental industry tend to favor the modified approach in that this approach provides a tool to government utilities to better plan for and maintain its infrastructure. Specifically, asset condition is carefully monitored and the cost of maintaining infrastructure at appropriate levels is identified. Already the American Public Works Association has endorsed the modified method as the preferred approach to infrastructure reporting for its member agencies.

EPA stands to benefit if agencies it regulates adopt the modified approach, and implement an asset management system. EFAB encourages EPA to take an active role in promoting GASB 34 and developing asset management systems. Initiatives that EPA might consider include:

- Providing incentives to reward those environmental utilities that have developed effective asset management systems compliant with GASB 34. Incentives might include:
  - economic payments for implementation of asset management compliant with GASB 34
  - recognition by state and/or federal environmental agencies
  - easier accessibility or more favorable terms to SRF funding for environmental infrastructure

- Providing full or partial grant funding for the development of asset management systems, particularly for small, disadvantaged communities
- Partnering with environmental associations in developing asset management guidance materials
- Expanding Capacity, Maintenance, Operations and Management (CMOM) as a vehicle to promote asset management
- Serving as a clearinghouse for the compilation and dissemination of asset management materials
- Preparing case studies of environmental utilities that have successfully implemented asset management systems.

We hope that you will find the recommendations constructive and useful. The Board is prepared to take any follow-up actions that are consistent with its charter. The members of EFAB appreciate the continuing opportunity to advise and assist EPA on important priorities. If you would like to discuss our findings and recommendations in more detail, we would be happy to meet with you and/or other members of Agency management you deem appropriate.

Sincerely,

/s/

A. Stanley Meiburg  
Executive Director

Enclosure

cc: Stephen L. Johnson, Acting Deputy Administrator  
Tracy Mehan, Assistant Administrator for Water  
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